Kentucky Law Journal

Volume 61 | Issue 1 Article 3

1972

Kentucky Adopts a New Business Corporation Act

Willburt D. Ham
University of Kentucky

Kentucky Adopts A New Business Corporation Act

BY WILLBURT D. HAM*

No doubt one of the most important pieces of legislation enacted by the 1972 Kentucky General Assembly was House Bill No. 178, providing Kentucky with a new Business Corporation Act.[1] Although given little general publicity at the time of its passage, this bill represented the culmination of some four years of careful and painstaking effort aimed at providing Kentucky with a corporation statute suited to the needs of modern business. The last comprehensive revision of the Kentucky general corporation statute occurred twenty-six years ago, in 1946.[2] While amendments to this statute had been adopted at subsequent legislative sessions in an effort to keep the statute current with new trends and developments in corporate law and practice,[3] the amendment process had reached the point of diminishing returns in terms of providing Kentucky with a modern, coherent,

* Professor of Law, University of Kentucky. B.S. 1937, University of Illinois; J.D. 1940, University of Illinois; LL.M. 1941, Harvard University.

1 KY. ACTS ch. 274 (1972).

2 Substantial portions of the 1946 General Corporation Law were taken from the Uniform Business Corporation Act, promulgated in 1928 by the National Conference of Commissioners on Uniform State Laws. 9 UNIFORM LAWS ANNOTATED 115, 117 (1957) [hereinafter cited as U.L.A.]. Reflecting some of the best corporate thinking of the day, the Uniform Act was one of the first of the scientifically drafted corporation statutes and for many years played a major role in the drafting of new corporation codes. Other states that drew heavily from the Uniform Act were Louisiana (1928), Idaho (1929), and Washington (1933). The Uniform Act was subsequently redesignated a Model Act and finally completely withdrawn from the active list of Uniform Laws in 1957. 9 U.L.A. 61 (Supp. 1967).

3 The process of "modernizing" corporation statutes has been going on at a steady pace in all parts of the country since the early part of the century. As of that time, the method of modernization had been largely by amendments to existing acts with the result that such acts tended to become a hodgepodge of amendments hard to read and understand. Although the amending process is still useful as an interim measure to keep corporation statutes current, most states have found that periodically a complete revamping of the corporation statute is desirable. For discussions of the modernization process as applied to corporation statutes over the years, *see* Rutledge, *Significant Trends in Modern Incorporation Statutes,* 22 WASH. U. L.Q. 305 (1937); Luce, *Trends in Modern Corporation Legislation,* 50 MICH. L. REV. 1291 (1952); Katz, *The Philosophy of Mid-Century Corporation Statutes,* 23 LAW & CONTEMP. PROB. 177 (1958).

integrated corporation statute comparable to similar statutes enacted in recent years by a growing number of other states.[4]

The impetus for the enactment of the new Kentucky Business Corporation Act came from an act of the 1968 Kentucky General Assembly directing the Kentucky Legislative Research Commission to study and evaluate the existing corporate laws of Kentucky with a view toward improving the corporate climate of the state.[5] It was noted in the 1968 Act that despite the rapid increase in industrial activity which Kentucky had enjoyed during the preceding decade there had not been a corresponding increase in the location of principal business offices and corporate headquarters in the state.[6] It was further observed that some large commercial establishments had even removed their business offices or corporate headquarters to other states, resulting in the loss of tax revenue to the Commonwealth and employment opportunities for its citizens.[7] The Legislative Research Commission was accordingly directed to engage in a comprehensive study and evaluation of Kentucky law pertaining to corporations and to recommend such revisions or modifications as might encourage the organization of corporations under the laws of Kentucky or the location of their principal business offices or corporate headquarters in the state.[8]

The Legislative Research Commission undertook this study and in October, 1969, published a report of its findings and conclusions.[9] This report examined the constitutional and statutory

---

[4] Ernest L. Folk, III, currently Professor of Law at the University of Virginia, who served as principal draftsman for the South Carolina Business Corporation Act, adopted in 1962, and who served as official reporter and advisor to the Delaware Committee on Revision of the Delaware General Corporation Law, in 1967, has pointed out that "since 1950, when the initial draft of the American Bar Association Model Business Corporation Act was published, a numerical majority of the states have totally or substantially revised their corporation statutes," and that "after 1960, the pace of revision seemed to accelerate, both in the number and importance of the states restructuring their statutes." Folk, *Corporation Statutes: 1959-1966*, 1966 DUKE L.J. 875, 876-77. New York, of course, completely revised its corporation statutes in 1961, effective September 1, 1963, followed by Delaware in 1967, and New Jersey in 1968. Some of the more recent comprehensive revisions, with effective dates, include Louisiana (1969); Montana (1969); Georgia (1969); Tennessee (1969); Rhode Island (1970); Vermont (1970); Maine (1972); and Kansas (1972).

[5] KY. ACTS ch. 207 (1968).

[6] *Id.*

[7] *Id.*

[8] *Id.* § 2(1).

[9] KENTUCKY LEGISLATIVE RESEARCH COMMISSION, INFORMATIONAL BULL. No. 76, CORPORATION LAW (1969) [hereinafter cited as CORPORATION LAW].

requirements governing corporate activity in Kentucky, pointed out certain inadequacies of Kentucky corporation law, and compared the 1966 and 1969 revisions of the Model Business Corporation Act[10] with the laws of Kentucky and other selected states. The report suggested ways in which the Kentucky corporation law could be updated, one of which called for a complete revision of the Kentucky general corporation statute using the Model Business Corporation Act as a guide.[11] The report pointed out that such a revision of the Kentucky corporation statute would provide those organizing corporations in Kentucky with a corporation code which would reflect modern legal procedures and encourage organization and relocation in Kentucky.[12]

Pursuant to this latter suggestion, House Bill No. 514 was introduced in the 1970 session of the Kentucky General Assembly. This bill represented a comprehensive revision of Kentucky's law relating to private corporations, based primarily on the 1969 revision of the Model Business Corporation Act, modified to retain certain requirements of Kentucky's existing corporation law.[13] This bill was not introduced until midway in the 1970 legislative session, too late for detailed review of its provisions. It was understood that the bill would be considered in detail dur-

[10] The Model Business Corporation Act, a product of the Committee on Corporate Laws of the Section of Corporation, Banking and Business Law of the American Bar Association, has undoubtedly had the most widespread influence on recent state statutory revisions. The Model Act was first published in complete form in the November, 1950 issue of *The Business Lawyer*, the quarterly publication of the Section of Corporation, Banking and Business Law of the American Bar Association. An initial, but incomplete, draft had been prepared and submitted in 1946 as a report to this Section of the Association. *See* Garrett, *History, Purpose and Summary of the Model Business Corporation Act*, 6 BUS. LAW. 1 (1950). Since the publication of the complete act in 1950, a number of addenda have been prepared by the Committee on Corporate Laws, consisting of revisions and amendments to the Act, the latest of which was adopted in 1969. The Model Act, as thus revised, has been published in pamphlet form by the Joint Committee on Continuing Legal Education of the American Law Institute and the American Bar Association. *See* ABA-ALI MODEL BUS. CORP. ACT (rev. ed. 1969) [hereinafter cited as MODEL ACT]. The 1969 revisions were the most extensive since the original publication of the Act. *See* the discussion of these revisions in Scott, *Changes in the Model Business Corporation Act*, 24 BUS. LAW. 291 (1968). In 1960 the American Bar Foundation published a three volume set entitled MODEL BUSINESS CORPORATION ACT ANNOTATED, containing a section-by-section analysis of the Model Act. A second edition of these annotations was published in 1971, containing the official text of the Model Act as revised through July 1, 1969. For the significance of the Model Act in the revision of state business corporation laws, *see* MODEL BUS. CORP. ACT ANN. 2D § 1 ¶ 2 (1971).

[11] CORPORATION LAW, *supra* note 9, at iv.

[12] *Id.* at 108.

[13] Kentucky Legislative Research Commission, Staff Memorandum No. 347, Corporation Law Project, at i (1970).

ing the 1970-71 interim between legislative sessions and that only less comprehensive revisions would be enacted at the 1970 legislative session.[14] Accordingly, a committee substitute for House Bill No. 514 was prepared and enacted, embracing some eight sections of the 147 sections contained in the original bill.[15]

During November, 1970, the Civil Law Subcommittee of the Joint Interim Committee on Judiciary scheduled a series of public hearings in Frankfort, Kentucky, dealing with the revision of Kentucky's corporation laws. The purpose of these hearings was to provide an opportunity for detailed consideration by interested parties of the comprehensive revision contemplated in House Bill No. 514, as originally introduced in the 1970 legislative session. In keeping with this purpose, the agenda for these hearings was based on the sections of House Bill No. 514. A transcript of these public hearings was taken and, in January, 1971, a bulletin containing this transcript was published by the Legislative Research Commission.[16]

In the early part of the summer, 1971, the Kentucky State Bar Association created a special committee to assist in the development of a new corporation law for the state. In the meantime, the staff of the Legislative Research Commission had prepared a new draft of the corporation bill containing the changes recommended at the November, 1971, public hearings. The newly formed bar association committee met with the Civil Law Subcommittee in Frankfort, Kentucky, on July 22, 1971. At that meeting, which was attended by other interested parties, including representatives from the Secretary of State's office, Attorney General's office, and members of the Legislative Research Commission staff, it was agreed that an opportunity would be provided the parties and groups represented at the meeting to submit written comments to the Legislative Research Commission concerning the proposed new draft. It was understood that the Legislative Research Commission would distribute copies of any such comments

---

[14] *Id.*

[15] KY. ACTS ch. 263 (1970). The eight sections related to the following subjects: corporate powers, issuance of stock in series, handling of surplus following a merger, indemnification of directors and officers, and merger or consolidation of domestic and foreign corporations.

[16] KENTUCKY LEGISLATIVE RESEARCH COMMISSION, INFORMATIONAL BULL. NO. 88, LEGISLATIVE HEARING: CORPORATION LAW (1971) [hereinafter cited as LEGISLATIVE HEARING].

to all interested parties for review. A special advisory committee would then be appointed by the chairman of the Civil Law Subcommittee to assist that Committee in preparing a final draft of the bill for filing with the 1972 General Assembly.[17]

Written comments were submitted to the Legislative Research Commission and compiled for study by members of the Civil Law Subcommittee and the special advisory committee. The most comprehensive comments were those prepared by the bar association committee.[18] These comments were contained in a thirty-two page memorandum submitted to the Legislative Research Commission.[19] The bar association committee report recommended close adherence to the Model Business Corporation Act in revising the business corporation law of Kentucky with departure only where essential to meet special circumstances such as those embodied in Kentucky constitutional provisions.[20] This general recommendation was based on two underlying considerations, (1) the expertise reflected in the 1969 revisions of the Model Act, and (2) the widespread adoption of that Act in substantial part by a growing number of states, thereby affording a common denominator for the development of a body of judicial decisions interpreting and applying the Act.[21] The specific recommendations contained in the bar association committee report related primarily to changes in the language of particular sections of the proposed bill to bring the wording into conformity with the language of the Model Act, to adjustments in certain sections of the bill to reflect the dictates of Kentucky constitutional provisions pertaining to corporations, and to alterations in the language of some sections of the bill from that used in the Model Act to reflect local practice or needs.[22]

Most of the changes and alterations in the proposed bill recommended by the bar association committee were approved at joint

---

[17] *See* Kentucky Legislative Research Commission, Minutes, Meeting No. 2, Subcommittee on Civil Law, Joint Interim Committee on Judiciary, July 22, 1971.

[18] The writer was privileged to serve as a member of both the bar association committee and the special legislative advisory committee and to participate in the deliberations on the proposed bill by each of these groups.

[19] *See* Kentucky State Bar Association, General Corporation Law Committee, Report with Respect to Revisions in the Kentucky Business Corporation Law, as submitted to the Kentucky Legislative Research Commission on September 14, 1971 [hereinafter referred to as Bar Association Committee Report].

[20] *Id.* at 2.

[21] *Id.* at 1-2.

[22] *Id.* at 5-32.

meetings of the Civil Law Subcommittee and the special advisory committee held during October, 1971.[23] Additional modifications in several sections of the bill were approved at these meetings as a consequence of a careful section-by-section analysis of the bill.[24] Following these meetings, the Legislative Research Commission was asked to redraft the bill to reflect the recommended changes. The revised draft was circulated to interested parties for comment, after which a final bill was prepared for introduction in the 1972 legislative session. This became House Bill No. 178, which was subsequently approved by both houses of the General Assembly with few changes.[25] The new act was approved by the Governor on March 27, 1972, and became effective July 1, 1972.[26]

I.

Through its new Business Corporation Act, Kentucky has taken a major step forward in making its corporation law more competitive with that of other states and providing its citizens with a corporation statute more responsive to the demands of the modern corporate world.[27] While there are deviations from some of the provisions of the Model Act, these deviations are minimal in comparison with the totality of the Act. Although the new statute contains a number of changes from the former Kentucky corporation statute, many of these changes reflect modern trends in corporation law, such as the dropping of the minimum capital requirement of $1,000 to begin business[28] and

---

[23] *See* Kentucky Legislative Research Commission, Minutes, Joint Meeting of the Civil Law Subcommittee and Corporation Law Revision Advisory Committee, October 13, 1971 and Joint Meeting of the Civil Law Subcommittee and Corporation Law Revision Advisory Committee, October 22, 1971.

[24] *Id.*

[25] The House vote was 93-0; the Senate concurrence was by vote of 32-0. 10 KY. LEG. REC. 63 (March 30, 1972).

[26] KY. ACTS ch. 274 (1972).

[27] It has been observed that the newer codes provide a needed elasticity to businessmen in organizing and structuring their corporate enterprise, while at the same time "offering reasonable protection to the legitimate interests of the public, the investing shareholders and creditors of the business." Treadway, *Liberalizing State Corporation Codes*, 11 WASHBURN L.J. 175, 178 (1972).

[28] KY. REV. STAT. § 271.085 (1971) [hereinafter cited as KRS]. In fact, the entire concept of conditions precedent to doing business, as contrasted with conditions necessary to incorporation, has been abrogated, along with the accompanying drastic penalty (formerly provided in KRS 271.095) of personal liability on directors and officers for the debts and liabilities of the corporation arising from business transacted in violation of the section. *See* Tri-State Developers, Inc. v. Moore, 343 S.W.2d 812 (Ky. 1961). The spectre of personal liability, however,

(Continued on next page)

the requirement that each incorporator must subscribe to at least one share of stock.[29] Furthermore, new and expanded provisions on a number of subjects serve to fill interstices which existed under the old statute. There are, for example, new provisions relating to the reserving and registering of corporate names,[30] dealing with ultra vires transactions,[31] authorizing the adoption of emergency bylaws,[32] pertaining to the removal of directors,[33] sanctioning shareholder voting agreements,[34] covering interested directors,[35] and permitting short form mergers,[36] as well as expanded financial,[37] foreign corporation,[38] director indemnification,[39] and involuntary dissolution provisions.[40]

Although most of the changes and additions in the new Business Corporation Act represent recent trends in corporation law on which there is general agreement, some involve important policy determinations on matters about which differences of opinion exist even among knowledgeable experts in the corporate

(Footnote continued from preceding page)
remains for those persons who transact business as a corporation before having received a certificate of incorporation from the Secretary of State. See KY. REV. STAT. ANN. §§ 271A.280 and 271A.670 (Supp. 1972) [hereinafter cited as KRSA], and the interpretation given comparable sections in the District of Columbia Business Corporation Act in Robertson v. Levy, 197 A.2d 443 (D.C. Cir. 1964). *Cf.* Cranson v. International Business Machines Corp., 200 A.2d 33 (Md. 1964).

[29] KRS § 271.035(1)(h). Local filing of corporate documents in addition to central filing is, however, retained. KRSA § 271A.275.

[30] KRSA § 271A.045 (reserved names); KRSA § 271A.050 (registered names); KRSA § 271A.055 (renewal of registered names).

[31] KRSA § 271A.035.

[32] KRSA § 271A.135.

[33] KRSA § 271A.195.

[34] KRSA § 271A.170(2).

[35] KRSA § 271A.205.

[36] KRSA § 271A.375.

[37] *See, e.g.*, the dividend provisions in KRSA § 271A.225; the provisions for distributions from capital surplus in KRSA § 271A.230; the special provisions relating to surplus and reserves in KRSA § 271A.350; the provisions pertaining to the pooling of interest treatment of accounts of constituent corporations in a business combination in KRSA § 271A.105; and the definitions of such important financial terms as net assets, stated capital, surplus, earned surplus, and capital surplus in KRSA § 271A.010. A special committee of the Kentucky Institute of Certified Public Accountants assisted the Civil Law Subcommittee by reviewing and commenting on selected financial provisions of the new Business Corporation Act which related particularly to accounting principles and practices.

[38] KRSA § 271A.520 to .610. The foreign corporation provisions have particular significance since, as noted in the 1969 Legislative Research Commission study, the foreign corporation provisions of the old corporation statute were fragmentary and incomplete, leaving foreign corporations contemplating expansion of operations into Kentucky without any clear specification of their duties and responsibilities. *See* CORPORATION LAW, *supra* note 9, at 14.

[39] KRSA § 271A.025.

[40] KRSA § 271A.475.

law field. A few of these deserve specific mention since they received special treatment in drafting the new statute.

II.

One such matter concerns director conflict of interests. There has long been a question as to the validity of transactions between a corporation and one or more of its directors, or between corporations having common directors.[41] This is a specific aspect of the fiduciary principle which requires a director or officer to give undivided loyalty to the interests of the corporation when acting in his official capacity.[42] Early courts took the position that any transaction involving a conflicting interest was absolutely voidable on the basis of the conflicting interest alone.[43] Gradually, however, courts relaxed this severe attitude in favor of the application of equitable principles of fairness to each transaction.[44] In recognition of this changed attitude, several states adopted statutes relaxing the conflict of interest rules.[45]

The provisions of the Model Act also reflect this modern trend.[46] These provisions declare that no transaction involving a director conflict of interest is to be considered void or voidable because of such interest if one of three conditions is met: (1) such interest is disclosed or known to the board of directors, which approves the transaction by a vote of a disinterested majority; or (2) such interest is disclosed or known to the shareholders, who approve the transaction; or (3) the transaction is fair and reasonable to the corporation.[47] On the surface, these provisions might appear to encourage laxity in director conduct and lead to a whitewash of all director conflict of interest transactions. The function of such provisions, however, is rather to dispel the

---

[41] H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 238 (2d ed. 1970).

[42] *Id.*

[43] Marsh, *Are Directors Trustees? Conflict of Interest and Corporate Morality*, 22 BUS. LAW. 35, 36 (1966).

[44] *Id.* at 43. The rule which has predominated until recently in a majority of jurisdictions is that contracts involving interested directors, otherwise fair, are nevertheless voidable unless approved by a disinterested quorum and voting majority of the board of directors. *Id.* at 39-43.

[45] California seems to have pioneered with such a statute in 1947. *See* CAL. CORP. CODE ANN. § 820 (Deering 1963). Later statutes reflect the influence of the California statute. *See, e.g.*, DEL. CODE ANN. tit. 8, § 144 (Supp. 1970); N.Y. BUS. CORP. LAW § 713 (McKinney 1963).

[46] MODEL ACT § 41.

[47] *Id.*

notion that such transactions are necessarily vulnerable solely because of the director's interest.[48] As a means of forestalling the possibility under the first two alternatives, involving director or shareholder approval, that such approval would serve to insulate a transaction from challenge even though the transaction might be clearly unfair, an introductory clause has been inserted in the Kentucky conflict of interest section before each of these alternatives specifying that the transaction not be manifestly unfair to the corporation.[49] This emphasizes the fact that the section is not intended to deprive the courts of their power, under general equitable principles, to invalidate a transaction for unfairness where a director conflict of interest exists.[50]

Another matter in the area of management relations which has received considerable attention in recent years has been the question of indemnification of directors and officers for expenses incurred in defense of litigation brought against them.[51] New York pioneered with legislation on this subject in 1941,[52] recognizing both the power on the part of corporations to grant directors such indemnification and the right of directors to receive such indemnification through court order, where not adjudged liable for negligence or misconduct in the performance of their duties.[53] Since then statutory provisions, both in New York and elsewhere, have been greatly expanded and refined.[54] The present

---

48 MODEL BUS. CORP. ACT ANN. 2D § 41 ¶ 2 (1971).

49 KRSA § 271A.205.

50 The word "solely" which appears in the first paragraph of the Kentucky section before the phrase "because of such relationship or interest" was also added to strengthen the intended meaning of the section. KRSA § 271A.205(1).

51 MODEL BUS. CORP. ACT ANN. 2D § 5 ¶ 2 (1971).

52 The original provisions were contained in Sections 27-a and 61-a of the former New York General Corporation Law. N.Y. LAWS chs. 209, 350 (1941).

53 The original sections were amended and consolidated in 1945, as sections 63-68 of the New York General Corporation Law. N.Y. LAWS ch. 869, §§ 1, 4 (1945). The need for the New York legislation was brought about by the decision in New York Dock Co. v. McCollum, 173 Misc. 106, 16 N.Y.S.2d 844 (Sup. Ct. 1939), in which the court held that directors could not obtain reimbursement of their counsel fees in successfully defending a derivative suit brought against them, in the absence of a showing of special benefit to the corporation. The susceptibility of directors to shareholder suits for alleged misconduct was regarded as one of the hazards of the office which they assumed. In other jurisdictions, however, a common-law right of indemnification has been recognized. *See In re* E. C. Warner Co., 45 N.W.2d 388 (Minn. 1950); Solimine v. Hollander, 129 N.J.Eq. 264, 19 A.2d 344 (Ch. 1941).

54 MODEL BUS. CORP. ACT ANN. 2D § 5 ¶ 2 (1971). The present New York indemnification provisions are found in Sections 721-27 of the New York Business Corporation Law. They are, however, somewhat more restrictive than the com-

(Continued on next page)

Model Act provisions[55] represent the culmination of a combined effort on the part of the draftsmen of the Model Act and the revisers of the Delaware corporation law to develop an indemnification statute suitable to modern conditions.[56] The Delaware provisions, therefore, as enacted in 1967, with the passage of the new Delaware General Corporation Law, are almost identical to the present Model Act provisions.[57] Both statutes contain carefully prepared provisions for indemnification of directors and officers for expenses incurred in both corporate and third party litigation. Under these statutes when indemnification is awarded by the corporation other than pursuant to court decree, a determination is required that indemnification is proper under the applicable standards of conduct provided in the statute.[58] Such determination must be made either by a disinterested quorum and voting majority of the board of directors, by independent legal counsel in a written opinion, or by the shareholders.[59] During the deliberations on the proposed draft of the Kentucky Act, some concern was expressed with respect to permitting a determination of indemnification to be made on the basis of a written opinion by independent legal counsel in view of problems

(Footnote continued from preceding page)
parable indemnification provisions in the Delaware corporation statute or the Model Act. For discussion of the recent indemnification statutes, *see* Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078 (1968); Sebring, *Recent Legislative Changes in the Law of Indemnification of Directors, Officers and Others*, 23 BUS. LAW. 95 (1967).

55 MODEL ACT § 5.

56 MODEL BUS. CORP. ACT ANN. 2D § 5 ¶ 2 (1971).

57 DEL. CODE ANN. tit. 8, § 145 (Supp. 1968).

58 In third party suits, a director or officer may receive reimbursement for his expenses "if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful." MODEL ACT § 5(a); DEL. CODE ANN. tit. 8, § 145(a) (Supp. 1968). In corporate suits, such a person may receive reimbursement "if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation" except that no such indemnification is to be made where such person "shall have been adjudged to be liable for negligence or misconduct in the performance of his duty to the corporation," unless the court determines that, despite such adjudication of liability in view of all the circumstances of the case, the person is fairly and reasonably entitled to indemnity. MODEL ACT § 5(b); DEL. CODE ANN. tit. 8, § 145(b) (Supp. 1968). The words "or not opposed to the best interests of the corporation" were inserted in each of the two clauses to cover the possibility of a suit brought against a director or officer because of his status as such but based on acts performed in his individual capacity such as involved in the well-known *Texas Gulf Sulphur* case. SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968). *See* MODEL BUS. CORP. ACT ANN. 2D § 5 ¶ 2 (1971).

59 MODEL ACT § 5(d); DEL. CODE ANN. tit. 8, § 145(d) (Supp. 1968).

created in determining the "independence" of legal counsel rendering the opinion. This alternative was, therefore, stricken from the Kentucky provisions on indemnification.[60]

In other respects the new indemnification provisions in the Kentucky Act would appear to represent a distinct improvement on the indemnification provisions contained in the former Kentucky statute by defining more precisely the nature and extent of indemnification and by removing a glaring deficiency regarding indemnification for amounts paid in compromise or settlement of claims asserted against directors or officers.[61] Under the old law, amounts paid in compromise or settlement by directors or officers could be reimbursed by the corporation, which led to the potentially anomalous result in corporate suits of such directors or officers receiving from the corporation the very amounts they had paid in compromise or settlement of the action brought against them.[62] Under the new Act, while amounts paid in settlement of third party suits may be reimbursed, no such amounts paid in settlement or corporate suits can be reimbursed.[63]

---

[60] KRSA § 271A.025. Similar reservations as to the provision for opinions by "independent legal counsel" have been expressed by Joseph W. Bishop, Jr., Professor of Law at Yale Law School, who has written extensively on the subject of indemnification of corporate directors and officers. He, too, notes the uncertainty surrounding the independence of "independent legal counsel." Bishop, *supra* note 54, at 1080. On the other hand, the alternative of "independent legal counsel" might afford some advantage to public issue corporations, since putting an indemnification question before the stockholders could prove unattractive to management in such corporations. See the remarks by Professor Bishop at an ABA National Institute concerning "Officers' and Directors' Responsibilities and Liabilities," held in New York City on October 21 and 22, 1971, as published in 27 BUS. LAW. 109, 121 (Special Issue, February, 1972). The needed flexibility for these corporations may perhaps be available through use of by-law provisions pursuant to paragraph (6) of the Kentucky indemnification section, which makes the statutory indemnification provisions nonexclusive. KRSA § 271A.025(6).

[61] For an analysis of the former Kentucky statute and its deficiencies, *see* G. WASHINGTON & J. BISHOP, INDEMNIFYING THE CORPORATE EXECUTIVE 141-43 (1963).

[62] The anomalous character of the former Kentucky provision was the subject of a cryptic observation by Professor George D. Hornstein of the New York bar some years ago: "A unique law passed the Kentucky legislature; it provides for repaying to the director not only his expenses, but 'any amount paid in compromise.' Can one imagine a more warped conception of fiduciary responsibility!" Hornstein, *New Aspects of Stockholders' Derivative Suits*, 47 COLUM. L. REV. 1, 10 (1947).

[63] KRSA § 271A.025. In 1970, a new subsection was added to the Delaware indemnification statute, not yet included in the Model Act, recognizing indemnification on behalf of the personnel of an absorbed or merged corporation by the surviving or resulting corporation. DEL. CODE ANN. tit. 8, § 145(h) (Supp. 1970). A new paragraph (8) was added to the Kentucky indemnification section to reflect this aspect of indemnification. KRSA § 271.025(8). Otherwise personnel of an absorbed or merged corporation might be treated as having no statutory rights to indemnification against the surviving or resulting corporation. See the

(Continued on next page)

III.

In the realm of shareholder litigation, the new Kentucky Act reflects a substantial change from the provisions of the Model Act pertaining to the conditions for maintaining derivative suits.[64] It is arguable that the conditions for maintaining such suits should be governed by rules of procedure adopted by the courts rather than by provisions in the corporation statute itself. However, when the present Rules of Civil Procedure were adopted in Kentucky,[65] no provision covering derivative actions was included, although such a provision did appear in the comparable Federal Rules of Civil Procedure.[66] This omission can probably be traced to the existence of a special provision in the old corporation statute dealing with the procedural aspects of derivative suits.[67] The former provision, however, lacked one feature of the Federal Rules particularly pertinent to the proper operation of the derivative suit, consisting of a requirement that no such suit be dismissed or compromised without the approval of the court upon such notice to the shareholders as the court might direct.[68] In other respects the old Kentucky statute followed the requirements of the Federal Rules that the plaintiff have been a shareholder at the time of the transaction of which he complains and that he have made proper demand on the directors, and, if necessary, the shareholders to obtain the action sought.[69] By way of contrast, the Model Act, while preserving the requirement that the plaintiff be a shareholder at the time of the transaction of which he complains, contains no requirement of demand on directors or shareholders, but does add a provision permitting the court to require plaintiff

(Footnote continued from preceding page)
comments of Professor Folk with regard to the Delaware provision in E. FOLK, AMENDMENTS TO THE DELAWARE GENERAL CORPORATION LAW (EFFECTIVE JULY 1, 1970) (prepared by Professor Ernest L. Folk III for Corporation Service Company) (1970).

[64] MODEL ACT sec. 49.

[65] The effective date was July 1, 1953. KY. R. CIV. P. 86.

[66] FED. R. CIV. P. 23.1 (formerly Rule 23(b) of the Federal Rules of Civil Procedure before the 1966 revision of the Rules). For a discussion of the background and history of Rule 23.1, *see* 3B J. MOORE, FEDERAL PRACTICE § 23.1.01 (2d ed. 1969).

[67] KRS § 271.605. *See* comments in Bar Association Committee Report, *supra* note 19, at 14-15.

[68] FED. R. CIV. P. 23.1. The provision relating to dismissal or compromise appeared in subdivision (c) of original Rule 23, prior to the 1966 revision of the Rules. *See* 3B J. MOORE, *supra* note 66.

[69] KRS § 271.605.

to pay the expenses incurred in defense of the suit if it believes the action was brought without reasonable cause[70] and a provision permitting the corporation to demand that plaintiff be required to give security for the reasonable expenses of the defendants named in the suit unless the plaintiff holds a stipulated minimum amount or value of stock in the corporation.[71] These latter two provisions are aimed, of course, at the evils generated by the "strike" or nuisance suit.[72]

Against this background, it became evident that, absent any provision in the Kentucky Rules of Civil Procedure relating to the maintenance of derivative suits, a suitable provision should be included in the new corporation statute covering the procedural aspects of these suits.[73] However, it was also recognized that certain initial policy determinations, involving such matters as time of ownership of shares, required efforts from the board of directors or shareholders to take the desired action, responsibility for costs, security for costs, and control of settlement, were essential prerequisites to drafting a suitable provision.[74] These were resolved by preserving the provisions in the old statute pertaining to time of ownership and demand on directors and shareholders as healthy prerequisites to the maintenance of such suits; by adding the necessity of court approval for settlements as an effective means of controlling the evils of the private settlement in such suits; and by rejecting as unnecessary at this time in Kentucky the Model Act provisions relating to responsibility for costs and security for costs.[75]

Another aspect of stockholder litigation calling for special consideration concerned the extent and scope of the appraisal remedy to be granted dissenting minority stockholders in the case of certain fundamental corporate changes.[76] The Model Act

---

[70] MODEL ACT § 49 (second paragraph).
[71] *Id.* (third paragraph).
[72] MODEL BUS. CORP. ACT ANN. 2D § 49 ¶ 2 (1971).
[73] Kentucky Legislative Research Commission, Minutes, Joint Meeting of Civil Law Subcommittee and Corporation Law Revision Advisory Committee, October 22, 1972, at 2.
[74] *Id.*
[75] KRSA § 271A.245.
[76] The appraisal remedy provides a means whereby shareholders who object to specified types of extraordinary corporate action can withdraw from the corporation and receive the fair cash value of their stock. *See* H. HENN, *supra* note 41, § 349.

grants this remedy in cases of merger or consolidation and sale of assets,[77] as did the former Kentucky statute,[78] and details the procedure to be followed by dissenting stockholders in availing themselves of this right to dissent.[79] However, the Model Act excludes the remedy in the case of shares listed on a national securities exchange unless the articles of incorporation otherwise provide.[80] The draft of the new Kentucky statute excluded in addition shares held of record by not less than 2,000 shareholders,[81] as in the present Delaware statute.[82] The reason for this latter exclusion when introduced in the 1967 revision of the Delaware General Corporation Law was that, since the appraisal remedy, is based on furnishing the dissenting shareholder through court-supervised appraisal with a kind of special market for disposal of his shares, such special market is not needed if a market already exists, as would be the case where stock is listed for trading on the securities exchanges or where a large enough group of shareholders exists to assure some kind of public market, even if thin.[83] Since there was considerable feeling during the discussions of the Kentucky bill that the mere presence of 2,000 shareholders did not provide sufficient assurance of a market active enough to warrant exclusion of the appraisal remedy under such conditions, this exclusion was dropped and the Model Act language limited to listed shares was reinstated.[84]

---

[77] MODEL ACT § 80. Most jurisdictions limit the appraisal remedy to these two general types of corporate action, although a few jurisdictions have extended the appraisal remedy to other kinds of fundamental corporate changes, such as amendments to the articles of incorporation which affect the rights of existing shareholders. *See, e.g.*, N.Y. BUS. CORP. LAW §§ 910(a), 806(b), 1005(a)(3) (McKinney 1963).

[78] KRS § 271.405(4) (sale of assets); KRS § 271.490 (merger or consolidation).

[79] MODEL ACT § 81.

[80] *Id.* § 80. The word "registered" appears in the Model Act but the word "listed" seemed more appropriate and is used in the Kentucky counterpart to this section. KRSA 271A.400. *See* LEGISLATIVE HEARING, *supra* note 16, at 63-64.

[81] Kentucky Legislative Research Commission, Bill Draft sec. 79 (1971) (prepared by the staff of the Kentucky Legislative Research Commission incorporating suggestions made at the public hearings, November, 1970). The provision in the bill draft excluded not only shares listed on a national securities exchange but also shares immediately convertible into shares listed on such an exchange. *See* LEGISLATIVE HEARING, *supra* note 16, at 60.

[82] DEL. CODE ANN. tit. 8, § 262(k) (Supp. 1970).

[83] *See* E. FOLK, THE NEW DELAWARE CORPORATION LAW 38 (1967) (prepared by Ernest L. Folk III for Corporation Service Company).

[84] KRSA § 271A.400. The exclusion as to convertible shares was also dropped.

IV.

Turning for a moment to the special problems of the close corporation, an important policy determination became necessary in the drafting of the Kentucky Act relating to the approach to take in meeting the needs of these corporations, keeping in mind that closely held corporations, with no shares publicly traded, make up the bulk of corporations organized under Kentucky law.[85] Two approaches are currently being used to meet the needs of these corporations. Under one approach, adopted by the Model Act and followed in most existing corporation statutes, the provisions needed to furnish the necessary flexibility in the organization and functioning of these corporations have been molded into the applicable sections of the statute.[86] Under the second approach, currently used in Florida,[87] Delaware,[88], Maryland,[89] and at least two other states,[90] special integrated close corporation statutes have been prepared as subchapters or groups of sections in the general corporation statute.[91] While this latter approach has its advantages, it does present problems of its own,[92] and the consensus in the drafting of the Kentucky Act was, therefore, to stay with the approach of the Model Act, particularly since special effort was made by the Committee on Corporate Laws in

---

[85] The distinctive nature of the close corporation as a business entity has received the increasing attention of courts and legislative bodies in recent years and as one commentator expressed it, the close corporation "is probably the only form of corporation with which a large proportion of lawyers are familiar." Scott, *The Close Corporation in Contemporary Business*, 13 BUS. LAW. 741 (1958).

[86] *See* MODEL ACT Preface at iii, in which the Committee on Corporate Laws made the following observation:

> The subject of close corporations calls for comment because of numerous suggestions that special statutory treatment would be useful. This view has been considered by the Committee over a period of years. Its conclusion is that the Model Act provides the flexibility required for ease of creation, management and administration of a close corporation without raising the problems that are generally posed by such a special statutory provision.

[87] FLA. STAT. ANN. §§ 608.70 to .77 (Supp. 1972) (enacted in 1963).

[88] DEL. CODE ANN. tit. 8, §§ 341-56 (Supp. 1968) (enacted in 1967).

[89] MD. ANN. CODE art. 23, §§ 100-11 (Cum. Supp. 1971) (enacted in 1967).

[90] Pennsylvania adopted the Delaware close corporation statute with minor changes in 1968. PA. STAT. ANN. tit. 15, §§ 1371-86 (Supp. 1972). The new Kansas General Corporation Code, effective July 1, 1972, also contains a series of integrated close corporation provisions. KAN. LAWS ch. 52 §§ 125-40 (1972).

[91] *See* the discussion of these special close corporation statutes in H. O'NEAL, CLOSE CORPORATIONS: LAW AND PRACTICE § 1.14b (1971).

[92] *See, e.g.*, Dickson, *The Florida Close Corporation Act: An Experiment That Failed*, 21 MIAMI L. REV. 842 (1967). One of the problems which must be faced in the development of an integrated close corporation statute is that of finding a suitable definition for such a corporation. *See* H. O'NEAL, *supra* note 91.

the 1969 revisions of the Model Act to fully adapt its provisions to the needs of the close corporation.[93]

Numerous sections of the Model Act reveal its adaptability to the needs of the close corporation, including the sections dealing with quorum requirements[94] and voting rights,[95] the section concerned with management,[96] and the sections dispensing with the need for directors' and shareholders' meetings.[97] In view of the cloud cast on voting agreements by the decision of the Kentucky Court of Appeals in the *Haldeman* case,[98] the provision in the Model Act recognizing the validity and enforceability of shareholder voting agreements (as distinguished from voting trusts),[99] is of particular significance.

In connection with the provisions pertaining to close corporations, an important policy choice offered by the Model Act was made in the drafting of the new Kentucky Act to preserve what was believed to be the existing understanding and practice in Kentucky. This choice relates to the subject of preemptive rights.[100] One provision of the Model Act, recognizing a modern trend in corporation statutes to deny the preemptive right except to the extent granted in the articles of incorporation, denies the preemptive right except as thus recognized.[101] The other provision, offered as an alternative choice, recognizes generally the preemptive right, with permission to limit or deny such right in the articles of incorporation.[102] This latter approach conforms

---

[93] MODEL BUS. CORP. ACT ANN. 2D § 35 ¶ 2 (1971).

[94] MODEL ACT § 32 (shareholders), § 40 (directors); KRSA § 271A.160 (shareholders), KRSA § 271A.200 (directors).

[95] MODEL ACT §§ 33, 143; KRSA §§ 271A.165, .665.

[96] MODEL ACT § 35; KRSA § 271A.175.

[97] MODEL ACT § 44 (directors' meetings), § 145 (shareholders' meetings); KRSA § 271A.220 (directors' meetings), § 271A.665 (shareholders' meetings).

[98] Haldeman v. Haldeman, 197 S.W. 376 (Ky. 1917).

[99] MODEL ACT § 34; KRSA § 271A.170(2).

[100] The preemptive right concerns the right of a shareholder to subscribe to his proportionate part of a new issue of shares. Recognized at common law, with certain rather well-defined exceptions, it can be of particular importance to the shareholders in a close corporation in preserving their proportionate interest in the corporation. *See* the discussion of the preemptive right as applied to the close corporation in H. O'NEAL, *supra* note 91, § 8.39.

[101] MODEL ACT § 26.

[102] *Id.* § 26A. The section contains several built-in exceptions to the existence of the preemptive right, covering situations such as sale of shares for other than cash, in which elimination of the preemptive right was thought to be ordinarily in the best interest of the corporation and its shareholders. Flexibility, however, is maintained by permitting removal of the exceptions through appropriate provisions in the articles of incorporation. *See* MODEL BUS. CORP. ACT ANN. 2D § 26A ¶ 2 (1971).

more closely to the treatment of the preemptive right in the former Kentucky statute,[103] and was chosen for the new Business Corporation Act,[104] since it was believed most Kentucky corporations would wish to have preemptive rights and this approach would thereby avoid the possibility of a draftsman failing to recognize the need for the addition of a preemptive rights provision in the articles of incorporation should the other approach be taken.[105]

V.

Finally, in an effort to strengthen the foreign corporation provisions of the 1972 Act, additional restrictions have been added to the Model Act provision relating to the transaction of business by a foreign corporation which has not obtained a "certificate of authority."[106] Under the Model Act, a foreign corporation which should have obtained such certificate of authority but which has failed to do so is prohibited from maintaining any action, suit or proceeding in the courts of the state until the certificate has been obtained.[107] The 1972 Kentucky Act requires that, in addition to obtaining the required certificate of authority before it may bring suit in a Kentucky court, the delinquent foreign corporation must have (a) paid to the Secretary of State a forfeiture of $250, (b) furnished the Secretary of State with information as to the time the corporation began to transact business in the state, (c) obtained from the Secretary of State a certificate that the corporation has paid all fees which would have been imposed on the corporation had it duly applied for and received a certificate of authority, and (d) filed with the Secretary of State a certificate from the Commissioner of Revenue that the corporation has paid all income and license taxes owed to the state.[108] This additional provision, modeled after an Ohio statute,[109] was included

---

[103] KRS § 271.035(1)(f).

[104] KRSA § 271A.130.

[105] *See* the recommendation to this effect in the Bar Association Committee Report, *supra* note 19, at 10.

[106] Under the foreign corporation provisions of the Model Act, as adopted in Kentucky, no foreign corporation has a right to transact business in the state until it has procured a certificate of authority from the Secretary of State. KRSA § 271A.520.

[107] KRSA § 271A.610.

[108] KRSA § 271A.610(2).

[109] OHIO REV. CODE ANN. § 1703.29 (Anderson 1964).

to discourage deliberate violations of Kentucky law by foreign corporations at the expense of locally incorporated businesses.[110]

VI.

The above comments have been intended as representative only of some of the more important deliberations that went into the preparation of the new Kentucky Business Corporation Act. Perhaps they will suffice to indicate that the 1972 Act was not the result of superficial or precipitous action, but was the product of a great deal of time and effort on the part of a number of dedicated individuals and groups desirous of producing for the citizens of Kentucky a modern corporation statute responsive to their needs. A more intensive and detailed discussion of the changes in Kentucky law effected by the new statute is contained in the symposium which follows. It is hoped that these discussions will aid the practicing bar, as well as the business community, in making the transition from the old to the new act.

One final observation seems appropriate. The new Business Corporation Act should not be treated as an immutable document containing the final word on the subject. The corporate world is a dynamic world and a constantly changing and evolving world. It is therefore easy for a corporation statute to become outdated and lose its vitality. Changes and additions to the new Business Corporation Act will no doubt be desirable from time to time, just as has been the case with similar statutes enacted in other jurisdictions. If the corporate bar and business community accept the challenge thereby presented and provide the necessary leadership for keeping the new Kentucky Business Corporation Act abreast of developments as they occur, the 1972 Act should continue to provide the citizens of Kentucky with a modern corporation statute adapted to their business needs. Certainly, enactment of the new law has contributed substantially to the achievement of this goal.[111]

---

[110] *See* Bar Association Committee Report, *supra* note 19, at 28-29. The Committee stated that this provision "is designed to discourage a foreign corporation from transacting business in Kentucky in deliberate violation of our law, relying on the notion that if the corporation needs to use the Kentucky courts it can always obtain a certificate without penalty or the payment of back taxes." *Id.* at 29.

[111] *See* Lewis, *Kentucky Corporation Law: The 1972 Model is Coming Soon*, 36 KY. BAR J. 46 (July, 1972).